

This letter discusses sales of software. See 86 Ill. Adm. Code 130.1935. (This is a GIL.)

August 16, 2007

Dear Xxxxx:

This letter is in response to your letter dated February 8, 2007, in which you request information. The Department issues two types of letter rulings. Private Letter Rulings ("PLRs") are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. Persons seeking PLRs must comply with the procedures for PLRs found in the Department's regulations at 2 Ill. Adm. Code 1200.110. The purpose of a General Information Letter ("GIL") is to direct taxpayers to Department regulations or other sources of information regarding the topic about which they have inquired. A GIL is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120. You may access our website at www.ILTAX.com to review regulations, letter rulings and other types of information relevant to your inquiry.

The nature of your inquiry and the information you have provided require that we respond with a GIL. In your letter you have stated and made inquiry as follows:

On behalf of a Texas Corporation, ABC is researching taxability laws in the state of Illinois. Please address the issues listed below, and provide a written response/determination on what topics would be subject to sales tax in your state.

A privately-held TX C-corporation is a provider of information governance solutions for law firms and corporations. They provide legal and technical expertise to customers who recognize the need for fast retrieval of large volumes of electronic data. The corporation does not have employees or a physical presence in Illinois.

Items of revenue are categorized as follows:

Data Processing

Billings for services related to data manipulation and data storage; data is received from the client on a variety of media (tape, hard drive, etc.), and loaded onto the corporation's hardware in TX. The data is then retrieved, restored, extracted and/or filtered. The corporation's own proprietary software is utilized to perform these services.

Please note that the corporation's data processing services do not encompass the addition of data, the performance of investigative services, or a conclusion regarding the content of data; data processing services result in the return of data to the customer (see 'Data Archiving and Hosting' below).

Data processing services may also be provided according to the client's specific governance mandates and/or regulatory compliance requirements. However, all such customer data is considered 'private'(owned by customers) rather than 'public'.

This revenue category includes services only, and does not include the creation of data output, storage, or reports; these services are included in 'Data Archiving and Hosting' below.

Data Archiving and Hosting

Subsequent to data processing, client data is then stored, maintained and hosted on the corporation's own hardware, either in its original format or in a modified format. The clients may then retrieve their data via on-line access to the corporation's website (i.e., electronically), by receipt of tangible media (tape, hard drive, etc.), or by physical delivery by one of the corporation's consultants (loaded directly onto the client's computer; i.e., 'load and leave' with no tangible product delivered). The customer determines the method of delivery.

Consulting or Professional Services

Hourly rates, daily rates, or 'flat fees' are charged for legal and/or technical expertise. Charges in this category are for services only, and do not entail the delivery of tangible product, written reports or data delivery.

Travel Entertainment

Billings for the reimbursement of travel and entertainment expenses incurred while delivering 'Consulting or Professional Services' above. All such expenses are reimbursement-basis only, without mark-up. They do not use a per diem billing structure for this category.

Inventory

Inventory sales are sales of tangible hardware, such as hard drives or tapes, which may or may not contain client data when delivered to the client.

Shipping

Shipping charges are shown separately on their invoice as a 'pass-through' of the actual shipping cost incurred. In some instances, they also include a mark-up, or handling fee, in addition to the shipping charge.

Software License

Fees charged for the sales of the corporation's software product where ownership of the software license pass to the customer. This software license would be considered a 'canned' product; the corporation does not produce custom software on a customer-by-customer basis. The software may be delivered electronically (by data transfer to the customer, or via customer download from the corporation's website), or via tangible delivery of the software on storage media.

Software Maintenance Contracts

Customers are charged a monthly fee or annual fee for the ongoing maintenance of purchased software (as per the 'Software License' category above); all such contract sales are 'optional' (i.e., the purchase of a software license does not require the purchase of the software maintenance contract). For this ongoing fee, customers are sent periodic upgrades to the software for no additional charge.

Based on the above information, please mail the written determination to the following address:

ADDRESS

Please also email the information. Contact me if you have any questions or need any additional information. Thanks.

DEPARTMENT'S RESPONSE

The Illinois Retailers' Occupation Tax Act imposes a tax upon persons engaged in this State in the business of selling tangible personal property to purchasers for use or consumption. See 86 Ill. Adm. Code 130.101. The Use Tax Act imposes a tax upon the privilege of using in this State tangible personal property purchased at retail from a retailer. See 86 Ill. Adm. Code 150.101. If no tangible personal property is being transferred to the customers, then no Illinois Retailers' Occupation Tax or Use Tax would apply.

Likewise, the Service Occupation Tax Act and Service Use Tax are imposed on the transfer of tangible personal property incident to sales of service. See 86 Ill. Adm. Code 140.101 and 160.101. If no tangible personal property is being transferred to the customers incident to the services provided, then no Illinois Service Occupation Tax nor Service Use Tax would apply. Illinois has no service tax.

Data Processing

A service that does not involve the transfer of tangible personal property is not subject to sales tax.

Data Archiving and Hosting

We do not know whether there is any transfer of tangible personal property incident to this service or not. However, if there is, this service may be subject to the Service Occupation Tax.

Servicemen may calculate their tax base in one of four ways: (1) separately stated selling price; (2) 50% of the entire bill; (3) Service Occupation Tax on the cost price if they are registered de minimis servicemen; or, (4) Use Tax on the cost price if the servicemen are de minimis and are not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act.

Using the first method, servicemen may separately state the selling price of each item transferred as a result of sales of service. The tax is based on the separately stated selling price of the tangible personal property transferred. If servicemen do not wish to separately state the selling price of the tangible personal property transferred, those servicemen must use the second method where they will use 50% of the entire bill to their service customers as the tax base. Both of the above methods provide that in no event may the tax base be less than the cost price of the tangible personal

property transferred. Under these methods, servicemen may provide their suppliers with Certificates of Resale when purchasing the tangible personal property to be transferred as a part of the sales of service. Upon selling their product, they are required to collect the corresponding Service Use Tax from their customers. See 86 Ill. Adm. Code 140.106.

The third way servicemen may account for their tax liability only applies to de minimis servicemen who have either chosen to be registered or are required to be registered because they incur Retailers' Occupation Tax liability with respect to a portion of their business. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). See 86 Ill. Adm. Code 140.101(f). This class of registered de minimis servicemen are authorized to pay Service Occupation Tax (which includes local taxes) based upon the cost price of tangible personal property transferred incident to sales of service. Servicemen that incur Service Occupation Tax collect the Service Use Tax from their customers. They remit the tax to the Department by filing returns and do not pay tax to suppliers. They provide suppliers with Certificates of Resale for the property transferred to service customers. See 86 Ill. Adm. Code 140.108.

The final method of determining tax liability may be used by de minimis servicemen not otherwise required to be registered under Section 2a of the Retailers' Occupation Tax Act. Servicemen may qualify as de minimis if they determine that their annual aggregate cost price of tangible personal property transferred incident to sales of service is less than 35% of their annual gross receipts from service transactions (75% in the case of pharmacists and persons engaged in graphic arts production). Such de minimis servicemen may pay Use Tax to their suppliers or may self assess and remit Use Tax to the Department when making purchases from unregistered out-of-State suppliers. Those servicemen are not authorized to collect "tax" from their service customers because they, not their customers, incur the tax liability. Those servicemen are also not liable for Service Occupation Tax. It should be noted that servicemen do not have the option of determining whether they are de minimis using a transaction-by-transaction basis. See 86 Ill. Adm. Code 140.109.

Consulting or Professional Services

A service that does not involve the transfer of tangible personal property is not subject to sales tax.

Travel Entertainment

Reimbursements of travel and entertainment expenses are not generally subject to sales tax.

Inventory

We do not have enough information to tell you what tax applies to an inventory sale. Assuming these inventory sales are retail sales, the following information may be helpful.

Retail Occupation Tax: Illinois retail sales are made by persons who either accept purchase orders in the State or maintain an inventory in Illinois and fill Illinois orders from that inventory. The Illinois retailer is then liable for Retailers' Occupation Tax on gross receipts of sales and must collect the corresponding Use Tax incurred by purchasers. See 86 Ill. Adm. Code 130.605(a). However, if both the locations of the property being purchased and the purchase order acceptance were outside of the State of Illinois, then such sales would only be subject to Illinois Use Tax at the rate of 6.25%.

In general, the imposition of the various local sales taxes in Illinois is triggered when “selling” occurs in a jurisdiction imposing a tax. The Department’s opinion is that the most important element of selling is the seller’s acceptance of the purchase order. Consequently, if a purchase order is accepted in a jurisdiction that imposes a local tax, that tax will be incurred. See 86 Ill. Adm. Code 270.115(b). The tax rate is fixed by the location of the seller, not the delivery location. The fact that the item being sold is shipped from out-of-State or from another Illinois location is immaterial for purposes of local taxes if the sale occurs through order acceptance in an Illinois jurisdiction imposing a local tax. For these transactions, the local tax will be incurred.

If a purchase order is accepted outside the State of Illinois, but the property being sold is located in an Illinois jurisdiction that has imposed a local tax (see, for example, Section 270.115(b)(3)), then the location of the property at the time of sale will determine where the seller is engaged in business for the purpose of determining the imposition of applicable local sales taxes.

When tangible personal property is located in this State at the time of its sale (or is subsequently produced in this State) and then is delivered in this State to purchasers, the gross receipts from such sales are subject to tax if the sales are at retail. See Section 130.605. However, subsection (b) provides that gross receipts are not subject to tax when the gross receipts are from sales in which sellers are obligated, under the terms of their agreements with the purchasers, to make physical delivery of the property from a point in this State to a point outside this State, not to be returned to this State, provided that such delivery is actually made. In addition, subsection (c) provides that gross receipts are not subject to tax when the gross receipts are from sales in which the sellers, by carriers (when the carriers are not also the purchasers) or by mail, under the terms of their agreements with the purchasers, deliver the goods from a point in this State to a point outside this State, not to be returned to this State, provided that such delivery is actually made.

Service Occupation Tax: If the inventory sale includes transfers of tangible personal property incident to a sale of service, then the Service Occupation Tax or Use Tax may apply. (See discussion of the Service Occupation Tax, above.)

Occasional sale: A person does not incur Retailers' Occupation Tax liability on the gross receipts from an isolated or occasional sale. See 86 Ill. Adm. Code 130.110. Consequently, the purchaser of that tangible personal property does not incur a corresponding Use Tax liability on that purchase. See 86 Ill. Adm. Code 150.101(d).

An isolated or occasional sale occurs when a company sells tangible personal property, such as machinery, equipment, or other capital assets, that the company has used in its business and no longer needs. The sale will not qualify as an isolated or occasional sale if the company holds itself out as being engaged in the retail sale of that type or similar type of tangible personal property. For example, if a seller of computers decides to sell computers that it has used internally, such sales would not qualify as occasional sales because the entity is in the business of selling computers and servers. This is true even if the equipment does not have the same memory or storage capacity or does not perform exactly identical functions as the items normally sold.

Shipping

As a technical proposition, handling charges represent a retailer’s cost of doing business, and are consequently always included in gross charges subject to tax. See 86 Ill. Adm. Code 130.410. However, such charges are often stated in combination with shipping charges. In this case, charges designated as “shipping and handling,” as well as delivery or transportation charges in general, are not taxable if it can be shown that they are both separately contracted for and that such charges are actually reflective of the costs of shipping. To the extent that shipping and handling charges exceed

the costs of shipping, the charges are subject to tax. As indicated above, charges termed “delivery” or “transportation” charges follow the same principle.

The best evidence that shipping and handling or delivery charges have been contracted for separately by purchasers and retailers are separate contracts for shipping and handling or delivery. However, documentation that demonstrates that purchasers had the option of taking delivery of the property, at the sellers’ location for the agreed purchase price, plus an ascertained or ascertainable delivery charge, will suffice. If retailers charge customers shipping and handling or delivery charges that exceed the retailers’ cost of providing the transportation or delivery, the excess amount is subject to tax.

Software License

Generally, sales of “canned” computer software are taxable retail sales in Illinois. Sales of canned software are taxable regardless of the means of delivery. For instance, the transfer or sale of canned computer software downloaded electronically would be taxable.

However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See subsection (c) of 86 Ill. Adm. Code 130.1935. Custom computer programs or software must be prepared to the special order of the customer.

If transactions for the licensing of computer software meet all of the criteria provided in subsection (a)(1) of Section 130.1935, neither the transfer of the software nor the subsequent software updates will be subject to Retailers' Occupation Tax. A license of software is not a taxable retail sale if:

- A) It is evidenced by a written agreement signed by the licensor and the customer;
- B) It restricts the customer’s duplication and use of the software;
- C) It prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party) without the permission and continued control of the licensor;
- D) The licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or permitting the licensee to make and keep an archival copy, and such policy is either stated in the license agreement, supported by the licensor’s books and records, or supported by a notarized statement made under penalties of perjury by the licensor; and
- E) The customer must destroy or return all copies of the software to the licensor at the end of the license period. This provision is deemed to be met, in the case of a perpetual license, without being set forth in the license agreement.

Charges for updates of canned software are fully taxable pursuant to Section 130.1935. If the updates qualify as custom software under subsection (c) of Section 130.1935, they may not be taxable. But, if maintenance agreements provide for updates of canned software, and the charges for those updates are not separately stated and taxed, then the entire agreements would be taxable as sales of canned software.

Please note that the license agreements in which the customer electronically accepts the terms by clicking ("I accept") do not comply with the requirement of a written agreement signed by the licensor and customer. In order to comply with the requirements as set out in (a)(1) of Section 130.1935 you must have a written "signed" agreement.

Software Maintenance Contracts

In general, maintenance agreements that cover computer software and hardware are treated the same as maintenance agreements for other types of tangible personal property. The taxability of maintenance agreements is dependent upon whether the charge for the agreement is included in the selling price of tangible personal property. If the charge for a maintenance agreement is included in the selling price of tangible personal property, that charge is part of the gross receipts of the retail transaction and is subject to Retailers' Occupation Tax liability. No tax is incurred on the maintenance services or parts when the repair or servicing is completed.

If maintenance agreements are sold separately from tangible personal property, the sale of the agreement is not a taxable transaction. However, when maintenance services or parts are provided under the maintenance agreement, the company providing the maintenance or repair will be acting as a service provider under the Service Occupation Tax Act. The Service Occupation Tax Act provides that when a service provider enters into an agreement to provide maintenance services for a particular piece of equipment for a stated period of time at a predetermined fee, the service provider incurs Use Tax based upon its cost price of tangible personal property transferred to the customer incident to the completion of the maintenance service. See 86 Ill. Adm. Code 140.301(b)(3).

Charge for updates of canned software are fully taxable pursuant to Section 130.1935. If the updates qualify as custom software under Section 130.1935(c), they may not be taxable. But, if maintenance agreements provide for updates of canned software, and the charges for those updates are not separately stated and taxed, then the whole agreement would be taxable as sales of canned software.

Assuming that the services provided, such as installation, phone support, training, and seminars do not require the transfer of tangible personal property to the recipients of those services, charges for such services are exempt if they are separately stated from the selling price of canned software. See Section 130.1935(b). If computer software training or other support services are provided in conjunction with a sale of custom computer software or a license of computer software, the charges for that training are not subject to tax.

If you require additional information, please visit our website at www.ILTAX.com or contact the Department's Taxpayer Information Division at (217) 782-3336. If you are not under audit and you wish to obtain a binding PLR regarding your factual situation, please submit a request conforming to the requirements of 2 Ill. Adm. Code 1200.110 (b).

Very truly yours,

Martha P. Mote
Associate Counsel

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